RENT CONTROL AND HOUSING ASSISTANCE: THE U.S. EXPERIENCE

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RENT CONTROL AND HOUSING ASSISTANCE: THE U.S. EXPERIENCE

INTRODUCTION

It is no secret that most of the housing advisors sent to Eastern Europe by the U.S. Agency for International Development have encouraged national governments to move away from public ownership and administered prices for rental housing toward private ownership and market prices. But such a shift leaves open the question of public responsibility for low-income tenants who cannot afford market rents. In the United States, we have been dealing with that issue in various ways for more than 60 years, and I hope to convey to my Czech audience the lessons we have learned—and those we have not learned!

This essay reviews the experience of our market economy with two kinds of government policies intended to help renters cope with perceived shortages of affordable housing. One line of policy entails administered prices for rental housing services; the other entails financial assistance to builders, owners, or occupants of rental dwellings. These topics do not exhaust the possibilities of housing policy, but were chosen because they are immediately pertinent to choices facing the government of the Czech Republic. As rental housing is privatized, market forces are pushing rents up, much to the distress of tenants whose rents heretofore been fixed in nominal monetary units and whose housing costs have been heavily subsidized from the public treasury.

HISTORICAL BACKGROUND

The federal government of the United States first became concerned with housing policy during the great depression of the 1930s, when millions of able-bodied men and women were unemployed and unable to keep up their rent or mortgage payments. First, the Congress created programs designed to protect homeowners from foreclosure, lending institutions from failure, and investors from loss of their savings. The Federal Home Loan Bank, a reserve bank for savings and loan associations, was created in 1932 to facilitate the flow of mortgage funds between investors and borrowers in different parts of the country. A Home Owner's Loan Corporation was created in 1933 to provide emergency refinancing to homeowners threatened with foreclosure of their mortgages. The Federal Housing Administration was created in 1934 to encourage the use of long-term self-amortizing mortgages and to reduce the risks of mortgage lending by insuring institutional lenders against borrowers' default. At the same time, those who deposited their savings with such lenders were insured against institutional failure by the Federal Savings and Loan Insurance Corporation.

Next, Congress addressed the housing problems of the poor, mostly urban renters or rural tenant farmers. The Housing Act of 1937 declared the federal government's intention to help the states "remedy the unsafe and insanitary housing conditions and the acute shortage of decent, safe, and sanitary dwellings for families of low income, in rural or urban communities, that are injurious to the health, safety, and morals of the citizens of the United States."[1] As the first step in meeting this commitment, the Act provided financial support to local public housing authorities that undertook to build and manage rental housing for low-income families ("public housing"). The local authorities could issue tax-free bonds for this purpose, and the federal government would pay the annual interest on the bonds.

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50 Stat. 888 (1937), Sec. 1.

These programs attracted a broad base of political support from middle-income homeowners and homebuyers who got mortgage credit on easy terms, from advocates for the poor who saw great promise in the public housing program, from lending institutions that benefited as risk-free intermediaries, from local governments seeking to improve housing conditions in their cities, and from the construction industry eager for opportunities to build new housing. However, the housing improvements thus set in motion were interrupted in 1942 by national mobilization for World War II. For the duration of the war, housing construction was directed entirely to the needs of defense workers and military personnel; wages and prices were controlled to forestall general price inflation. The price controls included freezing residential rents at their 1942 levels. At the end of the war, federal wage and price controls were dismantled, but some states and cities continued rent control within their jurisdictions.

RENT REGULATION SINCE 1945

The national rent freeze imposed during World War II was not designed to protect the poor, but was part of a program of wage and price controls intended to prevent general price inflation. In the wartime full-employment economy, incomes rose rapidly but consumer goods were in short supply because of war production. During the war, all wages and most prices were controlled by the federal Office of Price Administration, and the available goods were shared more or less equitably by rationing. To soak up the excess purchasing power, the U.S. Treasury aggressively marketed savings bonds redeemable after the war.

These measures were surprisingly effective. Although aggregate personal income in the United States increased by more than 60 percent, consumer prices rose only by 10 percent between 1942 and 1945 and residential rents rose by less than one percent. When wage and price controls were lifted in November 1945, inflation ensued: Consumer prices rose by nearly 34 percent, 1945-1948, then stabilized as production of consumer goods resumed. However, there seems to have been a subtle structural change in the price system after the war; between 1950 and 1970, consumer prices rose at an average rate of 2.4 percent annually despite abundant productive capacity in the economy.

Rent Control in New York City, 1946-1970

When federal rent controls were lifted, some states and some cities decided to continue the controls in their jurisdictions, on the grounds that their inhabitants faced a severe shortage of rental housing which enabled landlords to charge unconscionable rents. The most prominent case was New York City, which controlled the rents of pre-1946 dwellings until 1970, while permitting market rents in newly constructed dwellings. I led a team of economists and policy analysts from the Rand Corporation (a public policy research institution) invited by the Mayor of New York in 1968 to study the consequences of these policies and recommend changes if appropriate. That experience left me with an abiding distrust of rent control as an instrument of housing policy.

What we found in New York City was a very low vacancy rate sustained not by population growth or shortages of building materials but by losses from the housing inventory. Despite various housing construction programs assisted by both state and federal governments, more dwellings were lost from inventory each year than were replaced by new construction. Between 1960 and 1967, the inventory of "sound" housing grew by 2.4 percent, but the "dilapidated" inventory grew by 44 percent and the "deteriorating" inventory grew by 37 percent.

The rent controls imposed on pre-1946 dwellings—two-thirds of the privately owned rental housing in the city—had succeeded in keeping rents low. Between 1942 and 1968, landlords were granted only one general rent increase of 15 percent in 1953. The law also allowed case-by-case increases under various hard-to-satisfy conditions. Overall, we estimated that controlled rents had risen by an average of 2.0 percent annually over a period of 25 years. Our studies of operating records for public housing projects and private apartment houses in the city led us to the conclusion that operating costs plus the cost of good-as-new maintenance had risen by about 6.0 percent annually over the same period.

Of course, landlords faced with persistent operating losses did not pursue good-as-new maintenance policies; to maintain a positive cash flow, they allowed their buildings to deteriorate. Tenants paid ridiculously low rents, in some cases for six- to eight-room apartments that their families had occupied for years—but found that plumbing failed, heating was irregular, plaster fell from the ceilings, the halls and staircases were dirty, and landlords were unresponsive to their complaints. So began a war between tenants and landlords that led to the creation of new city bureaucracies and increasingly complex regulations to fix the mutual obligations of tenants and landlords and settle their disputes. By 1965, many landlords had despaired of ever returning their properties to profitability; in the next three years about 114,000 rental dwellings were boarded up or abandoned by their owners.

We recommended to the city that controlled rents be increased over a period of several years to market levels, and the control system then be dismantled. We also proposed that the burden of these rent increases on poor families be mitigated by a program of housing allowances.[2] The city council more or less enacted the first proposal in 1970; the Mayor was interested in the housing allowance concept but unable to fund it from city revenues. Shortly thereafter, housing allowances were taken up as a policy option by the federal government, with consequences I will describe shortly. In subsequent years, both the city and state governments have intervened in the city's rental housing market to restrain rent increases, but most rents have been allowed to follow the market.

Recent Experience with Rent Control in Other Jurisdictions

After 20 years of chronic but moderate inflation (about 2.4 percent annually), the national rate of increase in consumer prices jumped to 7.8 percent annually, 1970-80. Gross rents increased by 7.3 percent annually, and renters' household incomes appeared to lag behind.[3]

In fact, the median renter income, measured in constant dollars, fell by about 19.0 percent between 1969 and 1978; but it is not at all clear that the decline in the typical renter's purchasing power reflects the fortunes of individual renter families. Rising real incomes enabled many adults who formerly lived with relatives to form separate households in rental dwellings; between 1960 and 1978, the number of rented dwellings occupied by single persons living alone increased from 4.2 million to

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Lowry, DeSalvo, and Woodfill, *Rental Housing in New York City*, Vol. I (1970) and Vol. II (1971).

The rapid inflation of this decade was the direct result of the Arab oil embargo in 1973 and subsequent increases in international oil prices forced by the Organization of Petroleum Exporting Countries (OPEC). Gross rent, which includes heat, water, and electricity expenses whether paid by the landlord or paid directly by the tenant, is very sensitive to changes in oil prices. The figure in the text reflects an adjustment to compensate for a known bias in the rent index maintained by the Bureau of Labor Statistics. For documentation of the points made in the following paragraphs, see Lowry, "Rental Housing in the 1970s: Searching for the Crisis," in Weicher, Villani, and Roistacher, eds., *Rental Housing: Is There a Crisis?* (1981).

9.6 million, 36 percent of all rented dwellings. Although these single adults could afford to live alone, they had smaller incomes than the larger households to which they formerly belonged.

Moreover, landlords' operating costs were rising rapidly. Between 1970 and 1980, quality-adjusted rental revenue rose by 87 percent, while operating costs rose by 141 percent; net operating return in constant dollars declined by 37 percent. In short, the case for rent control, whether based on claims of housing shortage, landlords' exorbitant profits, or tenants' inability to pay, was weak. But because rent is such a large item in household budgets, the nation's renters complained loudly and effectively to their city councils. During the decade, some 125 municipalities adopted some form of rent control.

Common Features of Rent Control Ordinances

Although jurisdictions in a given state often borrowed legal language from each other, the scope of local rent control ordinances, the standards for allowable rent increases, and the enforcement mechanisms vary greatly. In some cases, the controls are very mild, merely cosmetic responses to popular feeling. In most cases, the controls are strong enough to reduce the rate of rent increase slightly; and in a few jurisdictions, they are strong enough to virtually halt rent increases. The most common provisions are described below.[4]

- Most apartments in multiple dwellings existing at the time the controls are legislated are subject to rent control. Public housing (already regulated), luxury apartments, and single-family houses are usually exempt. Mobile-home site rents are often controlled. The ordinance usually exempts apartment houses built after the control date, so as to encourage new construction of rental units; a few jurisdictions have subsequently imposed controls on such buildings.

- Rent controls are often assumed to be temporary, needed only until the perceived shortage of rental dwellings is remedied by new construction. Some ordinances require that controls be lifted on all or part of the inventory when a specified vacancy rate is achieved.

- The rent charged for each dwelling during a base period prior to the imposition of controls becomes the ceiling rent thereafter, usually without regard for the market conditions or special circumstances (e.g., a long-term tenant) that affected the base-period rent.

- Housing market conditions, general price inflation, and changes in the costs of owning and operating rental property are reviewed periodically by a rent control board, which is empowered to grant general rent increases if warranted. Some ordinances include formulas for such increases based on readily available statistics such as the consumer price index (CPI); others require special studies of landlords' operating costs.

- Landlords may obtain rent increases on individual apartments or buildings by submitting evidence of capital improvements, increased services, inadequate base rents or other factors. Some rent control boards require that a landlord applying for such an increase

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See Baar, *Guidelines for Drafting Rent Control Laws* (1983), for a systematic treatment of alternative legislative approaches to and criteria for rent control.

be in precise compliance with all regulations, including those that have nothing to do with the reasons for the proposed increase.

- ! Some ordinances allow landlords to raise rents on vacated units without limit; once the unit is reoccupied, the new rent becomes the base for subsequent adjustments. This provision offers rent relief to landlords, protects sitting tenants at the expense of movers, and leads to substantial differences in the rents of identical apartments within a building.

- ! In some jurisdictions, landlords are prohibited from withdrawing rental units from the market or converting them to condominiums. In others, they can do so only after paying relocation expenses for rental tenants who would be evicted by the landlord's plan.

Effects of Rent Control on Housing Markets

Two California cities—Berkeley and Santa Monica—have rent control systems that have kept rents well below their market levels for 18 years. Their ordinances delegate considerable discretion to an elected board that writes and enforces regulations, including deciding on periodic general increases in controlled rents. Because tenants outnumber landlords in the electorate, these boards have nearly always been dominated by pro-tenant members.

Rent control began in Berkeley in 1978; after 1980, the rent control board approved annual general adjustments sufficient to maintain 1978's net operating income from each building in nominal dollars—without adjustment for general price inflation. The Santa Monica board also linked annual adjustments to base-year net operating income, but allowed an annual inflation adjustment set at 40 percent of the change in the regional CPI during the preceding year. In neither city have landlords been permitted vacancy rent increases.

In both cities, the consequence over the past 18 years has been a substantial reduction in the inventory of rental dwellings as landlords who found a loophole in the board's regulations withdrew their buildings from the rental market. Also, low-income tenants—including students, elderly and disabled persons, and those receiving public assistance—have been displaced by people who can pay substantial "finder's fees" and who are more attractive as tenants. A study of property sales in Berkeley indicates that the first decade of rent control reduced the real market values of rent-controlled properties by about 50 percent; during the same period, the real market values of uncontrolled single-family houses rose by 55 percent.[5]

The City of Los Angeles also imposed rent control in 1978, citing a severe shortage of rental housing that justified rent control as a way to prevent excessive rent increases while allowing landlords a "just and reasonable" return on their investments. Los Angeles's ordinance is less restrictive than the controls imposed by Berkeley and Santa Monica. In Los Angeles, landlords were initially permitted to increase rents for continuing tenants at the rate of 7 percent annually, and up to 9 percent if the landlord paid for gas and electricity. When an apartment was vacated, the landlord could raise the rent to any amount, which became the base for future 7-percent increases. Data from a 1984 study show that, including vacant-unit rent increases, the average annual increase for controlled dwellings between the "freeze" in 1978 and a survey conducted late in 1984 was 12.8

St. John, *The Impact of Rent Controls on Property Value* (1990); *Rent Control in Perspective* (1993). "Real market value" means market price in constant dollars.

percent, about the same as in sur-rounding jurisdictions that did not have rent controls. During the same period, the CPI for southern California increased at an average annual rate of 7.9 percent.[6]

In 1985, the City Council revised the permitted annual rent increase to correspond to the previous year's increase in the CPI, but with a minimum increase of 3.0 percent and a maximum of 8.0 percent; the extra benefits for landlords who paid for gas and electricity were preserved, as was the rule allowing an unregulated rent increase after a dwelling was vacated. As of 1996, these rules are still in effect. Surveys conducted in 1984, 1987 and 1993 indicate that the average annual increase of controlled rents was about 4.3 percent, slightly more than the CPI increase during the same period.[7]

In fact, four separate studies of rent stabilization in Los Angeles agree that its main effect has been to redistribute income between long-term tenants (whose rents could only increase by a fixed amount) and recent movers (whose rents were temporarily decontrolled under the vacant-unit provision). The long-term tenants who benefited were mostly middle-aged to elderly white couples or single persons with low-to-moderate incomes. Other effects predicted by economic theory, such as deterioration of controlled dwellings and shrinkage of the inventory of rental dwellings were not really noticeable, presumably because the rent restrictions were so mild.

The earliest study, not discussed above because it lacked a good source of current housing market data, was very helpful in organizing the ideas underlying a rent-control analysis. Its review of U.S. rent control laws suggests that each law can be almost fully characterized by the answers to five questions, paraphrased below:

- How long will the law be in effect?
- What part of the housing inventory is controlled and what part is exempt?
- What rent increases are permitted for continuing tenants?
- What rent increases are permitted when a dwelling is vacated?
- Under what circumstances does a dwelling become permanently decontrolled?

Answers to these questions can be arrayed so that the potential effects of differently designed laws on rents, housing quality, and availability of rental dwellings range from trivial to severe. Laws of longer duration imply greater rent reductions, which reduce a landlord's cash flow and increase his incentive to undermaintain his property. The larger the proportion of the housing stock subject to control, the greater the market effect. Fewer grounds for rent increases and smaller permitted increases imply larger reductions from market rents. If some dwellings are permanently decontrolled

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Hamilton, Rabinovitz, Szanton and Altschuler, *The Rent Stabilization System: Impacts and Alternatives* (1985), pp. 11-13 and Exhibit 2. The text reports an average annual increase in controlled rents of 10.9 percent, but that includes a period of about a year before the rent freeze. The measure of rent used here includes utility expenses, whether paid by landlord or tenant. The main reason rents rose faster than the CPI during this period is that the OPEC cartel forced petroleum prices to rise, so the prices of residential heating fuel and electricity roughly doubled between 1978 and 1984.

Hamilton, Rabinovitz, and Altschuler, *The 1994 Los Angeles Rental Housing Study* (1985), Chart 53b.

(for example, when they are vacated), the proportion of dwellings under control will shrink over time and all market effects will diminish.[8]

Perhaps it would be a useful exercise to answer these questions for the current rent control law in the Czech Republic and for any alternatives under consideration.

HOUSING ASSISTANCE FOR LOW-INCOME RENTERS

Wartime full employment created a prosperous working class that, after the war, was eager to spend their savings on better housing. In 1949, the Congress supported these aspirations with a legislative commitment to realize "as soon as feasible ... the goal of a decent home and a suitable living environment for every American family."[9] The federal mortgage credit programs begun in the 1930s were revived, enlarged, and liberalized. Veterans of the armed services were offered mortgage credit on very generous terms. The construction industry adopted mass production techniques to build millions of moderately priced single-family homes in vast suburban tracts. Congress appropriated large sums to assist local governments with slum clearance and redevelopment; the slum clearance was usually quickly accomplished, but redevelopment was slow and usually emphasized public facilities and commercial uses; invariably, redevelopment resulted in a net loss of low-rent housing.

The public housing program grew slowly in the face of considerable opposition from private developers who objected to competing with the government[10] and from citizens disturbed by the prospective concentration of poor families in their neighborhoods. New programs of federally subsidized loans enabled private developers of multifamily projects to build rental housing for middle-income tenants essentially without financial risk. Other new programs of loans and grants were devised to assist homeowners to repair and improve their dwellings, often in conjunction with neighborhood rehabilitation. All these factors played a part in the rapid improvement of housing quality and affordability between 1950 and 1970.

Success, however, brought disenchantment. Twenty years of federal subsidies had created constituencies—home-builders, high-rolling real estate developers, mortgage lenders, and municipal governments—who were skillful at diverting subsidies from their public purposes to private agendas, or who demanded these subsidies even after the policy justification for them had been fulfilled by general housing improvement. Between 1970 and 1973, insistent questions were raised by the Congress, the Comptroller General, and the press about policy objectives, the feasibility of program missions, equity in the allocation of assistance, the effectiveness and honesty of program administration, and the long-run costs of current project commitments. In January 1973, the Secretary of the federal Department of Housing and Urban Development (HUD) imposed a moratorium on new subsidy commitments under existing programs, explaining that:

Paraphrased from Rydell and others, *The Impact of Rent Control on the Los Angeles Housing Market* (1981), pp. 41-42.

63 Stat. 413 (1949), Sec. 2.

The only real competition was with slum landlords. Those eligible for public housing could not afford new private housing, and public housing authorities used private construction contractors to build their projects.

> It had become crystal clear by 1970 that the patchwork, year-by-year, piecemeal addition of programs over a period of more than three decades, had created a statutory and administrative monstrosity that could not possibly yield effective results even with the wisest and most professional management systems.[11]

His successor ordered a massive review of the entire structure of HUD's housing assistance programs and of the fundamental premises of federal housing policy. The reviewers generally concluded that existing policy was fundamentally flawed by its outdated assumption that the basic problem was a shortage of decent housing, a shortage that could only be remedied by subsidizing new housing construction. In their view, the market was quite capable of providing a supply of decent housing for those able to pay for it; the residual problem was both narrower and more profound: the emergence of an underclass whose earnings, even during periods of national prosperity, were inadequate to support a decent level of living, who therefore economized on housing in order to pay for food. Instead of treating the root cause of the problem—the inability to pay for housing—the government was attacking the symptom—overcrowded or badly maintained dwellings. They proposed housing allowances for low-income families as a better way to address the real problem.[12]

The Housing Allowance Concept

Housing allowances are cash payments to low-income households that help them with their housing expenses and encourage consumption of better housing. Allowances are "demand subsidies," in contrast to "supply subsidies" that encourage private developers or public authorities to build and operate low-rent housing, or that encourage lenders to accommodate low-income homebuyers. Many variations are possible, but the following features jointly distinguish housing allowances from alternative forms of housing assistance:

! The amount of a family's allowance depends on household size and income and on the local cost of adequate housing for a household of that size. It does not depend on how much rent they actually pay. Consequently, participants have an incentive to shop for housing bargains and landlords are discouraged from overpricing the market.

! Allowance recipients find their housing in the private market. They negotiate the terms and conditions of occupancy with housing suppliers, and are entirely responsible for fulfilling such agreements.

! Allowance entitlement pertains to a specific household, not to a specific dwelling. When an assisted household moves, its allowance moves with it.

! The administering agency deals mostly with the assisted family. It has few commitments to landlords or other housing suppliers, and no contingent liability for recipients' delinquencies.

Romney, *HUD News* (1973), p. 7.

HUD, *National Housing Policy Review* (1976). Despite the publication date, the review was conducted in 1973. Its conclusions were endorsed by President Nixon in a special housing message to Congress on 13 September 1973.

- The allowance is at least indirectly earmarked for housing consumption, which distinguishes it from a general income transfer. The earmarking device may be either a minimum consumption standard or graduated compensation for increased consumption (more space, better quality).

In short, housing allowances provide low-income families with the means to pay for decent housing on condition that they obtain it from the private market by their own efforts. The concept applies as readily to homeowners as to renters. An allowance program does not sponsor housing construction or rehabilitation, although private developers, landlords, or the participants themselves might undertake such actions in response to the program.

The Experimental Housing Assistance Program

On paper, housing allowances were an attractive alternative to subsidized construction programs, which were very expensive per assisted family and therefore required deep subsidies to reach the targeted low-income population. Projects intended for the poor often ended up with middle-income tenants who could afford to pay enough rent to supplement the available subsidies for the projects in which they lived. Otherwise, developers might piggy-back subsidies from two or three sources in order to make a low-rent project financially attractive to investors.

By targeting subsidies on poor families rather than on landlords or municipalities, and by allowing the assisted families to live in existing rather than new dwellings, great fiscal savings over existing programs seemed attainable. But the coalition of interest groups that benefited from the existing programs warned that the principal effect of a housing allowance program would be a rent inflation that would not only require steadily increasing allowance payments, but would create hardships for renters not assisted. Consequently, in 1971 the Administration proposed and Congress approved the Experimental Housing Assistance Program (EHAP) to test the concept.

The experimental design produced by HUD with the help of three major research organizations was much more than a pilot or "demonstration" program. It was a serious attempt to apply scientific methods to understanding the underlying physical, financial, and behavioral patterns that must be changed in order to improve the housing conditions of the poor and to test the effectiveness of alternative incentives for change. Over a period nearly ten years, more than 30,000 households in 12 different cities and counties were enrolled in various versions of the program and were offered income-conditioned housing allowances if they could find decent, safe, and sanitary dwellings. Individual and market responses were carefully measured by means of administrative records and field surveys. During the experiment, participants received about $53 million in housing allowances; expenses of program administration amounted to about $23 million; and research expenses (experimental design, gathering and analyzing data not needed for administrative purposes) came to $82 million, for a total of $158 million.[13]

Not all things could be tested and not all tests were conclusive; but by 1980, the findings from EHAP had permanently altered the terms of housing debate in the United States by providing credible information about the quality of housing occupied by low-income families, the cost of bringing substandard housing up to national standards, the enrollment size and cost of a national housing

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Struyk and Bendick (eds.), *Housing Vouchers for the Poor* (1981), Table 12.1. HUD's accounting in 1982 led them to a total of $153 million, including runout costs for the Supply Experiment's allowance program.

allowance program, its probable effects on housing quality and market prices, and the fiscal efficiency of alternative ways of achieving housing improvement and relieving housing cost burdens.[14]

In 1982, the President's Commission on Housing recommended that future federal housing assistance be designed primarily to help poor families pay for existing private market housing rather than to help developers or local authorities build new housing. The commission also called for integration of mortgage finance with other capital markets through deregulation of thrift institutions, innovations in secondary mortgage-market instruments, and gradual federal withdrawal from mortgage finance.[15] In 1983, Congress agreed to terminate nearly all subsidies for new housing, as the administration had urged; however, Congress was reluctant to authorize genuine housing allowances, or "housing vouchers," as they came to be called. The new form of assistance did not gain a firm statutory base until the Housing and Community Development Act of 1987.

Section 8 Rental Assistance Programs

Although Congress authorized EHAP in 1971, it still resisted Administration pressure to end housing construction subsidies. In 1974, Congress ventured a compromise known as "Section 8 Lower Income Rental Assistance" that provided rent subsidies on behalf of low-income families living in privately owned dwellings under three circumstances: for newly constructed apartments, for apartments undergoing major renovation, and for existing rental housing. Local public housing authorities (PHAs) were the intermediaries for all three programs.[16]

In the first case, HUD offered subsidies to developers of new multifamily rental properties who would agree to reserve the apartments for tenants eligible for rent assistance under program rules, and would agree to charge no more than a "fair market rent" (FMR) specified by HUD for each metropolitan area in the nation. Qualified tenants paid 15 to 25 percent (later 30 percent) of adjusted income towards the rent and HUD paid the remainder, up to FMR. Typically, the housing authority contracted with the developer before the dwellings were built, guaranteeing the subsidy arrangement for 15 years. The property owner benefited by the guaranteed rent payments, but could accept only approved tenants and could not exceed HUD's FMR schedule. The tenants benefited by occupying an apartment whose FMR was usually several times the amount paid by the tenant; but a tenant who moved (or was evicted for cause) lost his subsidy entitlement.

The version for renovated buildings was similar to the above, with the exception that the building already existed; however, the subsidy contract and guarantee usually preceded the renovation.

In addition to the final reports of research teams that conducted the various components of EHAP (Supply Experiment, Demand Experiment, Administrative Agency Experiment), three systematic reviews of experimental findings have been published: Struyk and Bendick (eds), *Housing Vouchers for the Poor* (1981); Bradbury and Downs (eds.), *Do Housing Allowances Work?* (1981); and Friedman and Weinberg (eds.), *The Great Housing Experiment* (1983).

Report of the President's Commission on Housing (1982). This report, prepared at the beginning of the Reagan Administration, is an extraordinarily sophisticated and vigorous document, well worth reading today.

The following program description is taken from J. Paul Mitchell (ed.), *Federal Housing Policy and Programs* (1985), pp. 201-202.

The third version, for existing dwellings that did not need major renovation, was an important step toward housing allowances. Low-income families could apply to the local PHA for a Section 8 "certificate" which made them eligible for rent assistance if they could find an existing dwelling in that jurisdiction, a dwelling that was physically acceptable to HUD and rented for no more than FMR. The PHA then contracted with the owner to pay that part of the rent that exceeded the tenant's income-based contribution.[17] If the tenant was evicted or moved out voluntarily, the contract with the landlord was automatically terminated; the tenant retained his certificate of entitlement, which he could use elsewhere.

For nearly a decade, Section 8 remained the basic alternative to public housing. The number of assistance commitments made each year declined from 517,000 in 1976...to 112,000 in 1982. A 60 to 40 percent division between the Existing and the two Construction subprograms in 1976 became a 40 to 60 division during the last half of the Carter Administration, which favored supply over demand subsidies. At the end of 1980 Section 8 and public housing were each assisting about 1.2 million households. And after just ten years, Section 8 New Construction and Substantial Rehabilitation had produced more units than had public housing in over forty-five years.[18]

Housing Vouchers

In 1987, Congress added another variation to Section 8 that evolved into the present Housing Voucher Program. As it operates today, HUD contracts with a local public housing authority (PHA) to administer a program that allows pre-certified families to select existing dwellings anywhere in the jurisdiction. The monthly rent is a matter for negotiation between the prospective tenants and landlords; it can be higher or lower than FMR. If the dwelling meets HUD's standards of quality, the PHA contracts with the landlord to pay the difference between FMR and 30 percent of the tenant's adjusted income; the tenant pays the balance. The PHA's costs are reimbursed by HUD. This program embodies most but not all the principles of an ideal housing allowance program; its rules are detailed below.[19]

! Upon application to the PHA, an eligible family is issued a voucher certificate which promises rent assistance if the family can find a suitable dwelling within the jurisdiction. The PHA reviews the family's income and household composition and tells the family how much assistance they will get, so they can look for an affordable dwelling.

! Thus prequalified, the family searches the market for a suitable dwelling and negotiates the rent and conditions of occupancy with the owner of the property. The PHA does not

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An important consequence of this arrangement was that landlords entering the program immediately raised their rents, often to FMR (which depended only on the number of bedrooms and the presence or absence of an elevator). A program evaluation conducted in the mid-1970s reported a 26-percent average increase in contract rent for dwellings joining the program at the instance of a current tenant, when no repairs were required by the housing authority. See Rydell, Mulford, and Helbers, *Price Increases Caused by Housing Assistance Programs* (1980), for details, including a persuasive explanation of the failure of Sec. 8's so-called "shopping incentive," which was abandoned in 1980.

J. Paul Mitchell, op. cit., p. 202.

These details are abstracted from U.S. Department of Housing and Urban Development, 24 *Code of Federal Regulations*, Ch. VIII, Part 887 (1995).

participate in this negotiation, but it does inspect both the dwelling and the lease. The dwelling must be of suitable size for the assisted family and meet HUD's standards for decent, safe, and sanitary housing. The lease terms must be reasonable and may not contain provisions that put the tenant at a disadvantage in the event of disputes with the landlord; it must contain a provision that terminates the lease if the PHA terminates assistance to the tenant. The initial lease is for one year; thereafter, the landlord and tenant may agree to renew for either a longer or shorter period and other terms, including the amount of rent, may be renegotiated. However, the tenant must be able to terminate the renewed lease without cause after 60 days' notice.

! For a family of given size and composition, the amount of assistance equals the difference between the typical cost of suitable housing in that community (determined annually by HUD) and 30 percent of adjusted family income, and is adjusted at least annually to reflect changes in family circumstances or in market rents. Because the amount of assistance does not depend on the rent that the family actually pays, the family has a direct financial incentive to seek the least expensive dwelling that suits its circumstances.

! The PHA contracts with the landlord to pay the scheduled amount of housing assistance directly to the landlord as long as the assisted family occupies the unit and continues to qualify for assistance. The assisted family is responsible for paying the remainder of the agreed lease rent; if it fails to do so, the landlord can pursue the usual legal remedies for rent delinquency, including eviction. The PHA's contingent liability for a tenant's rent delinquency is limited to one month's unpaid rent; the PHA has no obligation to continue its assistance payments to a landlord after an assisted tenant has voluntarily vacated or been evicted from the dwelling.

! If an assisted family moves (after proper notice to the landlord), the PHA's contract with the landlord terminates. Under most circumstances, the family is entitled to find another qualified dwelling and negotiate an appropriate lease, whereupon the housing allowance is resumed. Normally, such moves are to dwellings within the jurisdiction of the PHA; however, PHAs are required by HUD to continue assistance to families who move to nearby jurisdictions, pursuant to mutuality agreements with neighboring PHAs.

! The landlord is responsible for maintaining the dwelling in decent, safe, and sanitary condition and for providing all utilities specified in the lease. The PHA inspects each assisted dwelling at least annually; if the dwelling fails to meet program standards and the landlord does not correct all defects promptly, the PHA may suspend or terminate assistance payments to the landlord even though the assisted family remains in residence. The family will usually move to another qualified dwelling where assistance payments can be resumed.

! If an assisted family's adjusted income rises to a level at which 30 percent of income equals or exceeds the lease rent, the PHA discontinues assistance payments to the landlord; the tenant is liable for the entire amount. If income falls thereafter, or family composition changes, assistance payments may be resumed; but if assistance payments are suspended for more than a year, the contract with the landlord automatically terminates and the tenant is no longer enrolled in the program.

For both the assisted families and their landlords, the rules described above seem to work rather well. Landlords willingly participate in the program because they can count on timely monthly payments from the PHA, usually equal to at least half of the market rental value of the dwelling and often much more. The assisted families are able to choose the location and style of dwelling (many are single-family houses, seldom available in public housing projects) and have no onerous duties other than submitting to a periodic means test. The PHA's housing inspections are probably more effective than tenants' complaints in eliciting maintenance or repairs, and trained inspectors are more likely than untrained tenants to identify some kinds of hazards to health or safety; thus, the public interest in decent, safe, and sanitary housing for low-income families is served.

This Housing Voucher Program falls short of a national housing allowance for low-income families in three respects:

! The program is available only to renters. HUD's estimates of housing cost burdens and physically deficient dwellings for 1993 indicate that about 45 percent of all households with very low incomes are homeowners (mostly elderly persons). About half of the low-income homeowners reported housing expenses higher than the standard for renter assistance, and nearly as many owners as renters reported physical defects in their dwellings.[20] Two of the EHAP sites in the 1970s included homeowners; in those experiments, the housing allowance format worked at least as well for homeowners as for renters and achieved more in the way of housing improvement.[21]

! Even for renters, it is not an entitlement program. Public housing authorities must apply to participate in the program, and their contracts with HUD specify the maximum number of assisted families and the dollar amount of assistance that HUD will provide for each year of a five-year contract. The number of eligible families in the PHA's jurisdiction is always much larger than the number that can be enrolled. Some of the eligibles benefit from other housing programs but nationally, only a fourth of all eligible renters get any form of housing assistance.[22]

! The PHA unnecessarily mediates between assisted tenants and their landlords. In the largest and longest experiments of EHAP,[23] the housing allowance office (HAO) dealt only with tenants, leaving the tenants to deal with their landlords (and leaving homeowners to deal with lenders and repair contractors). Tenants were not only responsible for finding their dwellings and negotiating leases, they also received the monthly assistance checks from the HAO and paid the landlord. If a tenant failed to pay his rent, the landlord had the usual legal remedies, but no claim against the HAO. The HAO periodically inspected

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U.S. Department of Housing and Urban Development, *Rental Housing Assistance at a Crossroads* (1996), Table A-1.

Lowry (ed.), *Experimenting with Housing Allowances* (1983), pp.139-166.

HUD, op. cit., Table A-6. About half of the renters with very low incomes are beneficiaries of other federal transfer programs (AFDC, OASI, SSI), but their cash benefits from these programs are counted as income for purposes of housing assistance. Benefits in kind (Food Stamps, Medicare, Medicaid) are not counted as income.

The Housing Allowance Supply Experiment. See Lowry, op. cit., for documentation of the findings presented in this paragraph.

assisted dwellings, reporting the results only to the tenant, who had to arrange whatever corrective action was needed. Often, the tenant would remedy reported defects without bothering the landlord. These arrangements worked well and resulted in very low administrative costs.

As compared to other forms of low-income housing assistance that we have tried in the United States, the great advantage of housing allowances is accurate targeting of benefits—both in terms of who gets help and how much help they get. No program that subsidizes landlords, public housing authorities, or housing developers has approached the transfer efficiency of housing allowances.[24] Regrettably, that strength is also a weakness: Programs that benefit poor people and no one else seldom acquire the vocal constituency needed to protect them from Congressional budget-cutters.

Epilogue: Developer Subsidies Revisited

A little-noticed provision of the Tax Reform Act of 1986 is a section that bestows tax credits on developers who promise to build rental dwellings affordable by low-income families. Each year since then, these credits have been allocated among the states in the amount of $1.25 per capita of population, a modest $300 million for the first year, but growing as population grows. The state housing agencies work out the deals with private developers, who must agree to keep rents below the market for 15 years. The amount of tax credit assigned to each developer is proportional to the project's equity financing.

In the subsequent decade, about $3.1 billion of such tax credits were distributed to the states—but each credit could be reused to offset taxes for ten years! By this provision, $3.1 billion in credits becomes $31 billion in foregone tax revenue. If all allocated credits were promptly taken up by developers, annual tax losses would climb from $300 million in 1987 to $3.1 billion in 1996, and thereafter would increase more slowly because of population growth. This arrangement could continue indefinitely and invisibly, inasmuch as no annual appropriation is needed to fund tax credits.[25]

Thus it appears that the developer's lobby has found the perfect vehicle for a long ride on the gravy train. The only difficulty that has emerged so far is that tenants eligible for low rents in assisted apartments must be households whose incomes are below 60 percent of the area's median income and rents must be no more than 18 percent of the area's median income. These restrictions define a rather narrow class of eligible and willing tenants, so many of the credits allocated to the states have not been taken up by developers. Probably the next move will be a legislative amendment that increases the eligible income to 80 percent of the area's median.

See Rydell, Mulford, and Helbers, *Price Increases Caused by Housing Assistance Programs* (1980); and Rydell and Mulford, *Consumption Increases Caused by Housing Assistance Programs* (1982); and Mayo, Mansfield, Warner, and Zwetchkenbaum, *Housing Allowances and Other Rental Housing Assistance Programs: A Comparison Based on the Housing Allowance Demand Experiment* (1980).

The original provision included a termination date for the program, but it has been extended several times. Although HUD participated in designing the criteria for awarding tax credits to developers, it does not oversee the program. Because it is a tax program, it is administered by the Treasury Department, which has no particular interest in the program's effects on the nation's housing. According to a senior official at HUD, that agency does not know the identity of the recipients of tax credits, the amounts they received, or the characteristics of the projects thus subsidized.

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